

Soon Lian Holdings Ltd

29 September 2021

Non-Rated

BBG	SLIAN SP
Market cap	S\$13.0m
Price (29 Sep 2021)	S\$0.12
52-week range	S\$0.05 – S\$0.152
Target Price	Non-rated
Shares Outstanding	108m
Free Float	30%
Major Shareholder	Tan Family 70.3%
P/BV (06/21)	0.4x
Net Debt to EBITDA (12/20)	2.6x

Source: Company data, Bloomberg, SAC Capital

Analyst

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Higher price and demand for aluminium

Soon Lian sources aluminium alloy products and cuts them to sizes for use in precision engineering (64% of sales), marine (17%) and other industries. The wind is in its sails as demand from end-users and aluminium prices, which recovered from Apr 2020, are expected to stay elevated.

The precision engineering industry is enjoying robust orders with the transition to green electric vehicles, and COVID-induced push for medical and tech devices. From Jan-Aug 2021, output from Singapore's precision engineering and electronics industries grew 19.9% and 19.6% yoy, respectively.

Price of aluminium has risen 48.1% YTD and is held up by 1) Reduced output in China (Aug -3.2% mom) due to suppressed smelting to reduce pollution and meet green targets, and power shortage. China accounts for 56% of global output; 2) Military coup in Guinea, world's second largest producer of bauxite, the raw material for production of aluminium; and 3) European smelters face with higher costs from carbon credit and energy prices.

This lifted 1H21 ROIC to 13.9% (FY20: 2.5%), which was also aided by S\$1.9m inventory impairment in 1H20 and a S\$0.2m writeback in 1H21. A relatively long cash conversion cycle, at 230 days (albeit an improvement from 304 days in FY20) have deterred new entrants and incumbents with weak balance sheets.

Annualised 1H21 EV/EBITDA of 2.3x and P/B of 0.4x have not priced in earnings potential from ASP and volume growth. The risks are contractions in China's construction activities and speculative orders from end-users leading to subsequent order cancellations. A softening in copper price could affect aluminium, which is an alternative.

Year End 31 Dec (S\$m)	FY16A	FY17A	FY18A	FY19A	FY20A
Revenue	34.2	37.7	33.7	31.1	33.4
EBIT	(1.3)	2.7	0.6	1.7	1.1
Net profit	(2.4)	1.6	(0.2)	0.8	0.4
EPS (S cents)	(2.3)	1.4	(0.2)	0.8	0.4
DPS (S cents)	0.8	0.7	0.2	-	-
Net cash / (debt)	(12.6)	(11.9)	(3.3)	(3.9)	(5.2)
Valuation					
EBIT margin (%)	(3.9)	7.3	1.9	5.4	3.3
ROIC (%)	(4.1)	7.3	1.4	4.6	2.5
EV/EBITDA (x)	(387.5)	13.1	11.5	6.1	9.0
P/E (x)	-	8.4	-	15.9	31.5
Dividend yield (%)	6.3	5.4	1.5	-	-

Investment Summary

Background

Founded in 1983, Soon Lian sources and supplies more than 1,300 aluminium alloy products, mainly to the marine and precision engineering industries. It also sells to traders and stockists for alloys used in other industries. Soon Lian cuts the alloys into forms and dimensions according to customers' specifications. Its operations and warehouses are located in Singapore, Malaysia, China and Taiwan.

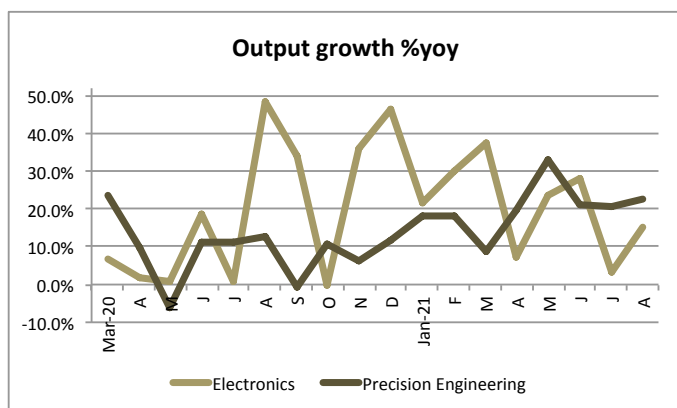
Aluminium alloy is a chemical composition of pure aluminium and other elements such as zinc to enhance its properties such as strength and corrosion resistance. Soon Lian sources from Austria, Greece, Italy, and smaller quantities from Japan and other countries.

The barriers to entry are long-term relationships with key suppliers for access to the products, and an established credit track record. The current supply chain bottleneck has lengthened the lead-time for shipment and raised working capital. Importers need strong balance sheets to stay in the game.



Its marine customers manufacture aluminium high-speed vessels and crewboats used for ferry, patrol and defence functions. This is a niche sector that caters mainly to government contracts. After a lull in 2020, orders have picked up.

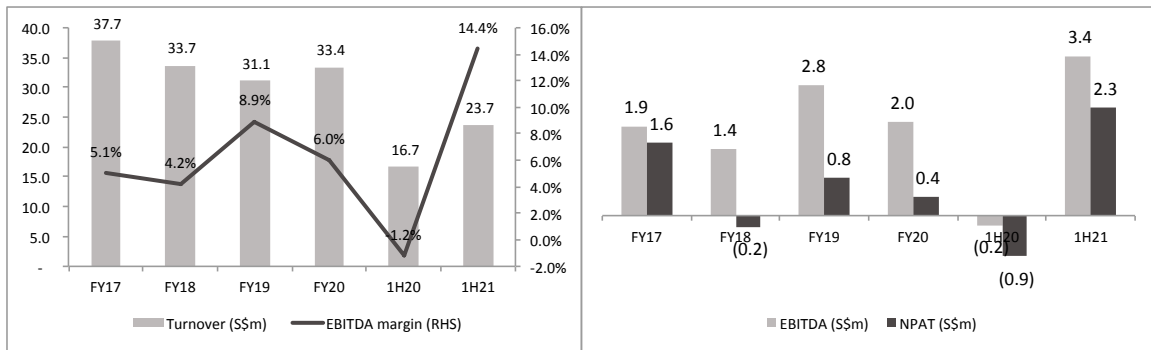
The use of aluminium in consumer electronic devices is growing as it is lightweight, anti-corrosive and have high electrical connectivity. YT August 2021, the output from Singapore's precision engineering and electronics sectors have grown by 19.9% and 19.6% yoy respectively. COVID-induced remote working and learning is fuelling demand for consumer electronics and internet devices. There is also replacement demand from the automotive industry as countries laid out targets for green vehicles.



Investment Summary

1H 2021 financial performance

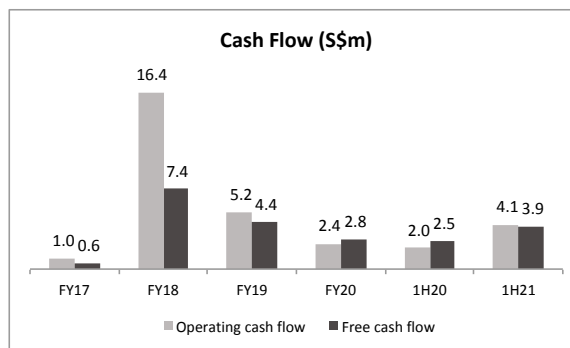
Higher ASP and volume shipped (compared to a low base in 1H20) drove revenue higher by 41.5% yoy and EBITDA margin to 14.4%. The higher margin was also due to a S\$1.9m provisions for impairment of inventory in 1H20 and a S\$0.2m writeback in 1H21, resulting in lower COGS in 1H21. ROIC rose to 13.9% (FY20: 2.5%).



As the fulfillment hub for its customers and with longer shipping lead time, inventory (S\$21.5m) amounts to 40% of total assets. Average inventory days have improved, but stay high at 220 days. Its operations are therefore highly susceptible to fluctuations in aluminium price. Receivables (S\$14.2m) account for another 26.6% of total assets. We believe the cash conversion cycle of 230 days is unlikely to be lowered as delivery lead time gets longer.

We expect higher cost of inventory in 2H21 as new shipments are received, and 2H21 margin to moderate. However, net earnings are expected to improve on higher volume.

In spite of the working capital needs, Soon Lian has been generating positive operating and free cash flows. It has net debt of S\$2.8m and net gearing of 8.5%, at 4% average cost of funds.



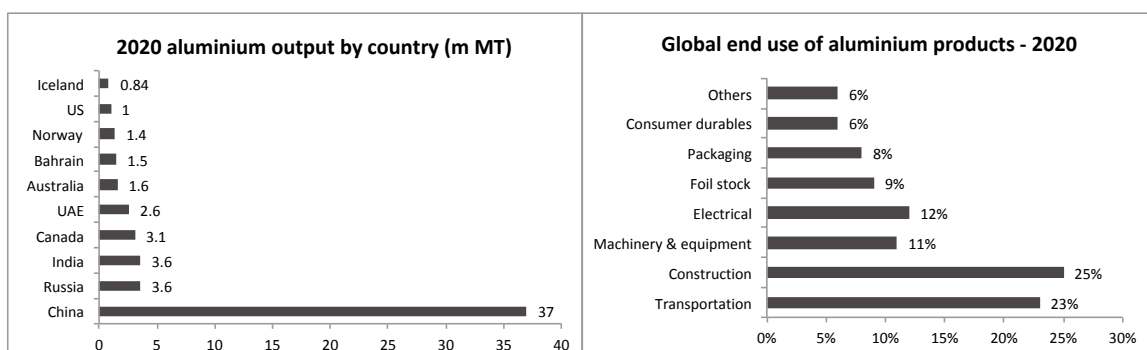
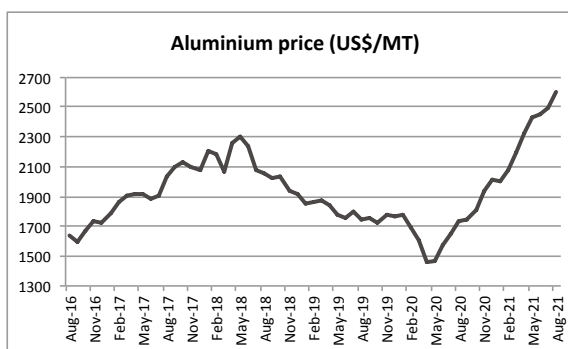
At a market cap of S\$13m, the stock is trading at FY21E annualised EV/EBITDA of 2.3x and P/B of 0.4x.

Investment Summary

Aluminium price

Price of aluminium has gained 48.1% YTD and is held up by: 1) Reduced output in China (Aug -3.2% mom) due to suppressed smelting to reduce pollution and meet green targets, and power shortage. China produces 56% of global output; 2) Military coup in Guinea, world's second largest producer of bauxite, which is used in the production of aluminium. Guinea is the largest supplier to China; and 3) Higher costs faced by European smelters with carbon credit and higher energy costs.

Prices are expected to stay elevated, supported by recovery in the developed economies, resumption in aerospace activities and lower smelting capacity. What could drive prices down are 1) a sharp contraction in construction and automotive production in China; 2) speculative and duplicate orders attracted by the high prices resulting in subsequent order cancellations; and 3) China's release of copper reserves might also affect the demand for aluminium, which is an alternative.



Peer comparison

The other Singapore listed aluminium alloy supplier is AEI. It is in the process of turning into a distributor of Moutai and other liquor and beverages.

	YE	Mkt cap (\$m)	Revenue (\$m)	EBITDA (\$m)	EBIT margin	ROE	ROIC	P/E (x)	P/B (x)	EV/EBITDA (x)
Soon Lian	Dec 20	13.0	33.4	2.0	3.3%	1.4%	2.5%	31.5	0.4	9.0
AEI	Dec 20	12.7	9.9	(1.7)	(55.0%)	(14.3%)	(45.6%)	n.a.	0.3	8.5

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